

No. 14,450

United States Court of Appeals
For the Ninth Circuit

GEORGE W. LEWIS,

Appellant,

VS.

UNITED STATES OF AMERICA,

Appellee.

REPLY BRIEF OF APPELLANT.

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INTRODUCTION.

The brief of appellee is singular in its omissions. It omits in its statement of the case what the entire record reveals as to the defendant's cooperation with the investigative officers in the furnishing of documents and records, including checks; it fails to point out where in the record there is firmly established for either of the prosecution years a starting point for its so called "net worth" method of proving tax evasion for those years; and finally it declines to discuss where in the record intent or wilfullness are shown by the admitted omission of certain items of income.

In short, the prosecution repeats here what it successfully accomplished in the trial Court. It assails

the reader with an array of figures showing expenditures in excess of reported income over an eight year period and asserts that such a showing is sufficient to sustain a conviction of tax evasion during the last two years.

In an effort to clarify the issues before this Court an attempt will be made to present an orderly reply to the Government's brief but the discussion will not follow the order followed there. Discussion will be directed first to those portions of the record which were not cited by the Government pertaining to the alleged failure of the defendant to cooperate with the agents and likewise those portions dealing with sources of income for the two years in question that were recorded but allegedly not reported.

Finally an analysis of the recent decisions of the Supreme Court concerning so called "net worth" prosecutions will be made to show that under the rules formulated there this conviction must be reversed.

1. WHAT THE RECORD SHOWS.

The Government states that the defendant refused to turn over his checks (R. 854) to the investigating agent. It fails to point out that such was done on the advice of his then counsel. Likewise it fails to point out that the record (R. 930-935) devotes five pages to answers given by the defendant concerning the only checks in which the Government was interested and none of such answers were false. The Gov-

ernment's brief refers to fragmentary portions of the testimony of its own witness William Anater who prepared the three returns that were the subject matter of this indictment. A reading of his entire testimony shows that records were furnished him by the various enterprises in which the defendant had investments and that such records contained full and adequate information from which to prepare the returns. (R. 299.)

The books and records of the various enterprises were subpoenaed by the Government and they failed to establish that there were false or fictitious entries contained therein, any attempt at concealment, or that there was any income from such enterprises not recorded properly.

Appellee implies that defendant concealed a partnership interest in the Universal Cleaners. The implication is improper. The prosecution witness John Bascon testified as to the nature of the transaction. (R. 137-141.) On cross-examination he clearly stated that the defendant was not a partner in the enterprise and that he, the witness, paid the income tax on whatever taxable income had been received.

The Government's brief refers to the failure of the defendant to report a so called partnership profit of \$43,198.44 from the Laurel Pottery Manufacturing Company for the year 1948. The Government's witness Anater testified on direct examination that he was the one that decided the item should not be reported by the defendant (R. 238-242) but rather that

it should be included in the income of the other partners who received the income; and he testified further that the other partners reported the income and paid taxes on it. (R. 301, 304.) Furthermore, as the record plainly reveals, the entire sum is clearly reflected in the books of account of the partnership and in its income tax return for the year in question. It is thereby inconceivable that a difference of opinion between the Government and a qualified accountant as to whom the income in question for technical reasons should be credited, could be made the basis of a criminal charge of evasion.

A reading of the record will reveal that the Government's reference to an undisclosed and unreported \$100,000.00 bonus in 1948 is lacking in merit. The deposition of John J. Gedert was read to the jury. (R. 580.) The original was filed with the clerk and has been transmitted to this Court as an exhibit. It was then disclosed that the witness Gedert had changed his testimony at the time the official reporter brought the deposition to him for reading, correction and signature. The witness at the time of his deposition stated that appellant in 1948 had received a salary of \$50,000.00 and a bonus of \$50,000.00 from the Detroit Racing Association. At the time the corrections were made, he doubled each of these figures. These changes were made in such a manner as not to be evident on the face of the deposition and were made in the absence of counsel. (R. 873-875; 890-894.) But the records of the Detroit Racing Associa-

tion and a firm of accountants were introduced into evidence and clearly showed the exact amount of salary and bonus received by the defendant in 1948 and that such amount was actually and accurately reported by him. The Government never disputed the accuracy of these records at any time prior to the filing of its brief on appeal.

2. RECORD INSUFFICIENT TO SUSTAIN THE CONVICTION.

Since the opening brief was filed herein the Supreme Court has handed down decisions in four of the cases cited in that brief which were then under consideration. They are:

Holland v. United States, 75 S.Ct. 127;
Friedberg v. United States, 75 S.Ct. 138;
United States v. Calderon, 75 S.Ct. 186;
Smith v. United States, 75 S.Ct. 194.

Appellee's brief in a footnote (pp. 21, 22) refers to these cases and states the Government's contentions were upheld by the Supreme Court in each of them. As a general statement that might be accurate. However an analysis of the decisions not only supports the conclusion that the safeguards and standards which the Court announced should be applied by trial and appellate Courts in prosecutions of this kind are not to be found in the record of the instant case, but also reveals that in one case (the *Calderon*) the use of the net worth method was in fact rejected.

In the first of these cases, *Holland v. United States*, 75 S.Ct. 127, Justice Clark writing the opinion of the Court expressed its concern over the increasing tendency of the Government to rely upon net worth methods of proof in prosecutions for income tax evasions. Pointing out that its widespread use indicated that the Government deemed it useful in the enforcement of the criminal sanctions of the tax laws, he stated:

"Nevertheless, careful study indicates that it is so fraught with danger for the innocent that the courts must closely scrutinize its use."

He went on to point out that reviewing Courts had become disturbed by the use of this method of proof particularly in its scope and the latitude which it allows prosecutors. The evolution of the system of proof was commented upon and the cases of *Capone v. United States*, 51 F. (2d) 609, and *Guzik v. United States*, 54 F. (2d) 618, were cited where the method was used to corroborate direct proof of specific unreported income. Likewise it was stated:

"In each of the four cases decided today the allegedly unreported income comes from *the same disclosed sources as produced the taxpayers reported income * * *.*" (Emphasis added.)

This factor alone distinguishes these cases from the instant case. Here there is no creditable evidence at all as to a source of income in the prosecution years which could conceivably account for the income which the Government alleges was unreported. Certainly the testimony of these witnesses Beezley and

Gaskill, neither of which pointed to a profit and both of whom were unable to identify the exact year in which the events they related occurred, can be viewed seriously—most certainly their testimony cannot found a criminal charge of tax evasion.

The opinion then points out six difficulties involved in using the net worth method, including the difficulty in convincing the jury of the existence of substantial amounts of cash not considered in the net worth computation; the confusion and conviction based on bare figures alone computed by the Government; the tendency to shift the burden of proof; the unreliability of the defendant's statement made in the course of an income tax investigation prompted by the hope of a quick settlement; and finally the difficulty of allocating to the respective indictment years the alleged deficiency and the possibility of a taxpayer being convicted on counts of which he is innocent.

The Court stated:

“While we cannot say that these pitfalls inherent in the net worth method foreclose its use, they do require the exercise of great care and restraint. * * * Trial Courts should approach these cases in the full realization that the taxpayer may be ensnared in a system which, though difficult for the prosecution to utilize, is equally hard for the defendant to refute. * * * Appellate Courts should review the cases bearing constantly in mind the difficulties that arise when circumstantial evidence as to guilt is the chief weapon of a method that is itself only an approximation.”

The opinion then reviewed the facts produced by the Government in support of the allegations of the indictment. The Government established an opening net worth computation at the beginning of the indictment period. It should be pointed out that in the instant case the Government *did not establish or attempt to establish* an opening net worth at the beginning of the indictment period.

The Court pointed out the necessity of establishing with reasonable certainty an opening net worth and stated:

“The importance of accuracy in this figure is immediately apparent, as the correctness of the result depends entirely upon the inclusion in this sum of all assets on hand at the outset.”

The Court then examined the contention of the defendants that the opening net worth figure was inaccurate because it failed to take into consideration cash saved over a long period. It examined the Government’s negation of this contention by proving a long period of economic adversity and hardship including the necessity of the wife’s employment for a considerable period prior to the indictment years. It then stated:

“Also requisite to the use of the net worth method is evidence supporting the inference that the defendant’s net worth increases are attributable to currently taxable income.”

Applying this rule the Court reviewed the evidence which showed that although the hotel business which

the defendants operated increased each year in question the reported profits fell to approximately one-quarter of the amount declared by the previous management in a comparable period; that cash register tapes had been destroyed and that the increase in net worth for one year was accounted for by unreported hotel income.

The Court held this evidence sufficient to negate any explanations of the defendant as to the possible sources of such increases. The Court stated (emphasis supplied):

“Increases in net worth, *standing alone*, cannot be assumed to be attributable to currently taxable income. *But proof of a likely source*, from which the jury could reasonably find that the net worth increases sprang, is sufficient.”

The Court pointed out that the disclosed business of the defendants was proven to be capable of producing much more income than was reported and in a quantity sufficient to account for the net worth increases.

In the instant case the record is devoid of any proof of a disclosed or undisclosed source of income sufficient to account for the expenditures made by the defendant. Their only origin was the cash accumulated in prior non-indictment years. That this was the only origin is manifest from the record in this case. That the accumulation of cash was in existence long prior to the indictment years was made known to the Government by the defendant. (R. 721-724.) Thus under the pronouncement of the Supreme Court

in the *Holland* case (supra) the failure of the Government to examine this lead should have been ruled as a fatal flaw of this prosecution.

Outlining the pitfalls encountered by the innocent who are prosecuted by the use of the net worth theory the Court had this to say:

“While sound administration of the criminal law requires that the net worth approach—a powerful method of proving otherwise undetectable offenses—should not be denied the Government, its failure to investigate leads furnished by the taxpayer might result in serious injustice. It is, of course, not for us to prescribe investigative procedures, but it is within the province of the courts to pass upon the sufficiency of the evidence to convict. When the Government rests its case solely on the approximations and circumstantial inferences of a net worth computation, the cogency of its proof depends upon its effective negation of reasonable explanations by the taxpayer inconsistent with guilt. Such refutation might fail when the Government does not track down relevant leads furnished by the taxpayer—leads reasonably susceptible of being checked, which, if true, would establish the taxpayer’s innocence. When the Government fails to show an investigation into the validity of such leads, the trial judge may consider them as true and the Government’s case insufficient to go to the jury. This should aid in forestalling unjust prosecutions, and have the practical advantage of eliminating the dilemma, especially serious in this type of case, of the accused’s being forced by the risk of an adverse verdict to come forward to substantiate leads which he had previously furnished the Govern-

ment. It is a procedure entirely consistent with the position long espoused by the Government, that its duty is not to convict but to see that justice is done.”

The record here shows that in the early 1940s the defendant was interviewed by agents of the Internal Revenue Bureau who were investigating his financial condition. He told the agent:

“Well, if you want to find out how much I’ve got, there’s the suitcase under the table. Go in and count it.” (R. 723.)

At the time the defendant stated he had a million dollars in currency in the suitcase. That this is a probable fact is gathered from a reading of all the record which reveals that from the year 1906 until the middle thirties the defendant was in the book-making business. His stock in trade or inventory was currency. It could be said of him that all of his money was tied up in cash.

The evidence as to his interview by agent O’Connell was uncontradicted. It is assumed that if such testimony was false the Government could quite easily have produced its own agent, Mr. O’Connell, as a rebuttal witness, but this was not done. This constituted evidence of a lead which the taxpayer had furnished the Government—a lead reasonably susceptible of being checked, which, if true, would establish the taxpayer’s innocence. It was the type of lead, which, if not checked and found untrue, the Supreme Court says, must be taken as true—and the trial Court holds as a matter of law that the evidence, based solely

on the approximations and circumstantial inferences of a new worth computation, is insufficient.

Holland v. United States, 75 S.Ct. 127.

There was no evidence in this record that the defendant was ever in economic want or his financial position throughout the years precluded his amassing the fortune he claimed. The record supports such a claim. The deposition of John J. Gedert already referred to shows that he was lending large sums of money, currency, to the money room at the Detroit racing track in the middle thirties. The testimony of Gene Normile (R. 581-605) shows that the defendant in the late twenties was possessed of large amounts of cash and that he booked "come back" money at Tia Juana to the extent of \$150,000.00 a day. (R. 585.)

Thus the record presented here is far different from the one in the *Holland* case or in *Friedberg v. United States*, 75 S.Ct. 138, where the claims to large amounts of cash was overcome by a history of privation and economic hardship suffered by the taxpayers during the time they claimed to have made the accumulation.

The Government in its attempt to overcome the facts rely solely on the uncorroborated extrajudicial statements of the defendant as to his financial status in 1941. (Exs. 14F, 58.) The circumstances under which such statements were given was explained by the defendant; that he made them in order to settle tax claims he felt were unfair, unfounded and arbitrary. Justice Clark's words with regards to such statements in the case of *Holland v. United States*, 75 S.Ct. 127, are appropriate. There he stated:

“But when a Revenue Agent confronts the taxpayer with an apparent deficiency, the latter may be more concerned with a quick settlement than and honest search for the truth.”

The Government in its brief states that it is not required to set a net worth at the start of the indictment period. They assert that fixing it at any time prior is sufficient because it is a mere mathematical calculation to move it forward. No cases are cited in support of this assertion. It is true that the past financial history of the taxpayer may be scrutinized but in every case examined a fixed net worth was established for the beginning of the first indictment year.

The Supreme Court in the case of *United States v. Calderon*, 75 S.Ct. 186, rejects the contention of the Government in this regard and held that resort to the net worth method of proof was not valid where the uncorroborated statements of the defendant and a sketchy financial background was all the evidence offered.

Here the Government relied solely on the 1941 uncorroborated statements of the defendant at a time when he was seeking a settlement of disputed tax deficiencies. It is obvious that if this figure is unreliable a mathematical computation based thereon is likewise unreliable.

It was stated in the case of *Holland v. United States*, 75 S.Ct. 127, where the starting net worth figure was the first prosecution year:

“We agree with petitioner that an essential condition in cases of this type is the establishment,

with reasonable certainty, of an opening net worth to serve as a starting point from which to calculate future increases in the taxpayer's assets. The importance of accuracy in this figure is immediately apparent, as the correctness of the result depends entirely upon the inclusion in this sum of all assets on hand at the outset."

That all assets on hand were not computed is demonstrated by the Government's own Exhibit 62 (Appendix) and its stipulations concerning the cash transactions of the defendant within the first sixteen days of January, 1947. (See Appellant's Opening Brief, pp. 15-17.) As a consequence a proper starting point was not fixed within the standards laid down by the decisions herein cited.

CONCLUSION.

A reading of the latest pronouncements by the Supreme Court in the four cases herein cited show that the safeguards and standards of proof which the Court states must be maintained by trial and Appellate Courts in these prosecutions are lacking in this record.

The Government is no longer permitted to amass an array of figures and calculations based on uncorroborated statements of the taxpayer made many years prior and then place the burden of proving innocence upon the defendant. The Government is required to show a likely source of income and not permit the jury to engage in tenuous speculation concerning some

possible source. Nor can the Government overlook or withhold leads furnished it by the taxpayer and reasonably capable of examination as to their truth and then be heard to say that its evidence is sufficient when it is based entirely on approximations and calculations not related to the facts.

It is submitted that in keeping with the language of the Supreme Court this Court should review this entire record and reverse this conviction because it was not obtained by application of the principles pronounced in those cases. If this Court is required to scrutinize with care convictions obtained through the net worth method of proof, certainly a conviction obtained by what is termed by the Government to be an "outgrowth" of that method requires careful consideration, especially where as here defendant was required to prove his innocence not only of written but also unwritten charges of tax evasion.

Dated, San Francisco, California,
January 3, 1954.

Respectfully submitted,
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